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SUBJECT: SERBIA: RUSSIAN INVESTMENT - THREAT OR MIRAGE?

REFTEL: A) Belgrade 365 B) Belgrade 93 C) Belgrade 382

SUMMARY

1. (U) Russia is the largest exporter to Serbia exporting \$2.6 billion in mainly oil and gas in 2007, while Serbia exported only \$450 million to Russia. Although Russian trade accounts for 14.3% of Serbia's 2007 total imports, Russian foreign direct investment is low and investors are non-committal. Russian is the 18th largest investor in Serbia, behind Norway, Austria, Germany, and Greece, among others. The Gasprom-NIS deal would be the largest Russian investment yet, but it may not be the precursor to a Russian investment invasion as some fear. Russian firms have pulled out of and lost interest in large deals like mining firm RTB Bor and perhaps JAT Airlines. END SUMMARY.

BILATERAL TRADE

2. (U) Russia is the clear benefactor of the Serbian-Russian Free Trade Agreement (FTA) signed in August 2000. Although Russia has not ratified the FTA, it is in effect. The customs free advantage coupled with Russia's proximity and oil reserves makes it the largest source for Serbia's imports, accounting for 14.3% of Serbia's imports or \$2.6 billion in 2007. Almost 75% of Russian exports to Serbia are energy related with crude oil making up 49% and natural gas 25%. In addition, Russia exports aluminum, fertilizer, cooper wire, and lubricants to Serbia. Disproportionately, Serbia exported \$450 million to Russia in 2007, with equipment, floor products, paper, pharmaceuticals, apples, and corn as top exports. Total trade between the countries in 2007 rose almost 44% from 2006. In the first quarter of 2008, Serbian exports to Russia totaled \$196 million, up 92% compared to first quarter 2007. Russian imports were up 64% at \$1.4 billion. The increases were due mainly to higher oil and gas prices and Serbian domestic demand.

ONLY A FEW DONE DEALS

3. (U) Although imports from Russia are substantial, foreign direct investment (FDI) is not. According to the Serbian Chamber of Commerce, total Russian FDI between 2000 and 2007 was \$500 million, placing it as the 18th largest investor behind Norway, the United States, Germany, and Austria and many others. Russia's largest investment yet was Lukoil's purchase of 80% of state-owned Beopetrol in 2003 for \$336 million (\$187 million purchase price, \$136 million of future investments, and a \$13 million social program). At an August 20 press conference, Moscow-city owned Moscow Bank announced it would begin operations in October 2008 after it received a greenfield license and invested the regulatory minimum \$24 million. The bank said it would look at acquiring local banks in order to expand operations, including outside Belgrade. In August 2008, as the sole bidder in a privatization auction, Russian auto parts

producer Avtodeltal Service bought 39.2% of the region's largest bus manufacturer Ikarbus for \$10.7 million. Smaller investments--often in partnership and consortium with other companies--are across sectors including food, energy, and industrial products.

14. (SBU) Russia's interest in large state-owned companies up for privatization is also low. Second bidder Strikeforce Mining and Resources (SMR), part of Basic Element, failed to close the deal with GOS to buy copper mining and smelting complex RTB Bor after the government cancelled the contract with first bidder Austrian company A-Tech (ref A). SMR would not agree to fulfill several deal requirements to purchase the company. Russian billionaire Oleg Deripaska owns Basic Element, a diversified investment company with global assets in the energy, resources, manufacturing, financial services, construction and aviation sectors. Russian air carrier Aeroflot was seen as the most serious suitor for JAT Airways, however, Aeroflot announced in July 2008 it probably would not bid for JAT citing too high a purchase price and soaring fuel costs.

BUT, MORE TO COME

15. (SBU) Russian investment in Serbia's energy sector, however, could catapult Moscow to the top rungs of foreign direct investors. The much debated deal involving Serbian state oil firm NIS (ref B) would inject at least \$640 million into the Serbian economy and \$800 million in future investments. Expanding its interest in energy, state-owned Russian electricity trading and management company Inter RAO signed a protocol of cooperation in April 2008 with Serbian state-owned electricity company EPS to build new hydro, thermo, and gas production capacities in Serbia and in the region (ref C). In late July 2008, an Inter RAO delegation met with new Mining and Energy Minister Petar Skundric to discuss future projects. Skundric

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is an honorary professor at the Technology Institute of St. Petersburg.

RUSSIAN INTEREST VS. ACTION

16. (SBU) In an August 8 meeting Assistant Minister for Foreign Economic Relations in the Ministry of Economy Jelena Marjanovic told us the Russians had often declared their interest in investing in Serbia, but their talk was often not followed with action. Serbian Chamber of Commerce's Advisor for Russia Vesna Nikolic Ugrica echoed this sentiment to us in an August 11. As for the FTA, both officials believed the FTA would benefit Serbia in the long run as it would attract other European countries to establish operations in Serbia to enter Russia customs-tax free. However, Ugrica said Serbia wanted to expand the list of goods it could export to Russia, which could not be done until Russia ratified the FTA. Earlier this year, Russian Finance Minister Alexei Kudrin proposed that Russia ratify the FTA after Serbia ratified the Gasprom-NIS deal.

17. (SBU) In an August 22 meeting, Russian Embassy officials Andrej Hripunov and Holin Aleksandrovic told us Russian investors were interested in all sectors of the Serbian economy. They said the energy sector was of specific interest as Russia had a competitive advantage in the sector and Russia was involved in most energy projects in the former Yugoslavia. The two hailed Serbia as dynamic in spite of its political issues, but admitted that bureaucracy and changes in administrations and legislation were serious concerns. The representatives insisted that Russian investors did not ask for "special favors" and that their deals were "open and transparent," including the Gasprom-NIS deal.

COMMENT

18. (SBU) Although the daily coverage of the Gasprom-NIS deal might suggest an onslaught of Russian investment, Russian investors' (both private and state) actions would suggest otherwise. Russian investors seem to be as cautious as U.S. investors and instead have focused on Russia's competitive advantages: oil and gas. Desperate to decrease the more than \$5.2 billion trade deficit, Serbia is not

concerned about the origins of foreign direct investment, just with attracting it. Outside of the energy deal, Russia is showing little interest in expanding its economic reach in Serbia. As with Russian support for Kosovo, Serbs are finding themselves with empty promises and no real evidence of critical Russian interest in Serbia, except to further Russia's political agenda. End Comment.

MUNTER